#2598 signed 4-22-03

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF KANSAS

In Re:	
JON STERLING WOMACK, **CYNTHIA ANN WOMACK,**	**CASE NO. 97-42738-7** **CHAPTER 7**
DEBTORS.	
VERLIN A. INGRAM, **ROBERT BROWN,**	
PLAINTIFFS,	
v.	**ADV. NO. 02-7165**
JON STERLING WOMACK,	
DEFENDANT.	

ORDER DETERMINING OBLIGATIONS WILL BE NONDISCHARGEABLE UNLESS MATERIALLY ALTERED THROUGH STATE COURT APPEAL AND ANY SUBSEQUENT PROCEEDINGS

This proceeding is before the Court for decision based on portions of the trial record in a state court proceeding, plus certain additional material presented by the defendant. Plaintiffs Verlin A. Ingram and Robert Brown appear by counsel Kevin B. Johnson. Defendant-debtor Jon Sterling Womack appears by counsel Allen M. Hickey. The Court has reviewed the relevant materials and is now ready to rule.

FACTS

Debtor Womack and his wife filed a Chapter 13 bankruptcy petition in October 1997, listing plaintiff Ingram in their schedules as an unsecured creditor. Ingram filed a proof of claim indicating that he believed Womack owed him money as a result of a law partnership between them. After obtaining stay relief, Ingram filed an action in Kansas state court for dissolution of the alleged partnership. In May 1999, the state court entered a restraining order requiring both Womack and Ingram to retain in their respective trust accounts, pending further order of the court, any attorney fees and expenses they might receive in a number of specified client matters. This order had been orally announced at a hearing held during the previous February.

Womack and Ingram tried to resolve their differences through mediation, and reached at least a tentative settlement in July 1999. The state court would eventually find that the settlement was binding on the parties, but that the parties were subsequently unable to agree on a journal entry that would resolve the dissolution proceeding. According to Womack, he made a tender to Ingram in June 2000 of the money due under the settlement agreement by offering all the money he had in his trust account, but Ingram rejected it. Apparently, Womack believed that the rejection of his tender, coupled with his duty to preserve the assets of his bankruptcy estate, somehow relieved him of any obligation to comply with the restraining order, and he spent the disputed fees that he had held in his trust account or otherwise received.

In May 2001, the state court held a hearing on Ingram's motion to obtain approval of the settlement and resolve the partnership dispute. Both Ingram and Womack testified, and certain deposition testimony of others was presented. The court concluded that the parties were bound by the settlement, and that Womack owed Ingram $40,224.84 under the settlement. The court found that

Womack violated the settlement agreement by failing to pay Ingram or to hold the money in trust. The court also found that Womack had violated the restraining order by disposing of fees that were to be held in trust pending further order of the court. The court concluded that Womack was in contempt of court for violating the restraining order, and specifically rejected Womack's assertion that Ingram's rejection of a tender of payment excused his violation of the order. In addition to the $40,224.84 due under the agreement, the court ordered Womack to pay $11,500 in attorney's fees and $623.10 in expenses that Ingram incurred with Brown because of the violation of the restraining order. The court awarded prejudgment interest on the $40,224.84, and postjudgment interest on the full amount awarded to Ingram. Womack appealed the judgment, but the Kansas Court of Appeals has stayed the appeal because of Womack's bankruptcy case.

The Womacks voluntarily converted their bankruptcy case to Chapter 7 in September 2002. In amended schedules, they listed Ingram as an unsecured creditor owed $40,225, and Brown as an unsecured creditor owed $11,150. As this Court reads the state court's journal entry, the entire amount was actually awarded to Ingram, who of course would be liable to Brown for the fees. In any event, Ingram and Brown joined in a dischargeability complaint, contending that the state court judgment is covered by 11 U.S.C.A. §523(a)(4) and (6). At the Court's request, Ingram and Brown have indicated that the evidence they would present in this proceeding would be just the trial record before the state court, while Womack has indicated that he would present the trial record and would also testify about the issues of fraud while acting in a fiduciary capacity, and willful and malicious injury to the property of another, testimony he says was not given before the state court. The Court then asked the parties to submit copies of the state court's restraining order, and the settlement agreement

that the state court found, with one modification, was binding on the parties (identified as "Exhibit 2" during the trial). These materials were supplied, and Mr. Womack also submitted a document that is essentially a brief explaining his legal arguments in this proceeding. Having reviewed these and other relevant documents filed with this Court, the Court concludes that the dischargeability of Womack's obligations under the state court's order presents only legal issues, and that no additional evidence needs to be received.

DISCUSSION AND CONCLUSIONS

Ingram and Brown contend that Womack's obligations under the state court judgment are nondischargeable under 11 U.S.C.A. §523(a)(4) or (6). These statutes provide:

> (a) A discharge under section 727 . . . of this title does not discharge any individual debtor from any debt—
> . . .
> (4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny;
> . . . [or]
> (6) for willful and malicious injury by the debtor to another entity or to the property of another entity.

The Court will address the provisions in order.

The Tenth Circuit has construed the "fiduciary capacity" portion of §523(a)(4) narrowly. In *Fowler Brothers v. Young (In re Young)*,[1] the Circuit said:

> The existence of a fiduciary relationship under § 523(a)(4) is determined under federal law. However, state law is relevant to this inquiry. Under this circuit's federal bankruptcy case law, to find that a fiduciary relationship existed under § 523(a)(4), the court must find that the money or property on which the debt at issue was based was entrusted to the debtor. Thus, an express or technical trust must be present for a fiduciary relationship to exist under § 523(a)(4).

[1]91 F.3d 1367, 1371-72 (10th Cir. 1996).

> Neither a general fiduciary duty of confidence, trust, loyalty, and good faith, nor an inequality between the parties' knowledge or bargaining power, is sufficient to establish a fiduciary relationship for purposes of dischargeability. Further, the fiduciary relationship must be shown to exist prior to the creation of the debt in controversy.[2]

On the other hand, in *Antlers Roof-Truss & Builders Supply v. Storie (In re Storie)*,[3] the Tenth Circuit Bankruptcy Appellate Panel construed the "defalcation" portion of §523(a)(4) broadly, saying:

> We conclude that "defalcation" under section 523(a)(4) is a fiduciary-debtor's failure to account for funds that have been entrusted to it due to any breach of a fiduciary duty, whether intentional, wilful, reckless, or negligent. Furthermore, the fiduciary-debtor is charged with knowledge of the law and its duties. Once a creditor objecting to the dischargeability of a debt under section 523(a)(4) has met its burden of showing that the debtor is a fiduciary and that its debt has arisen because the debtor-fiduciary has not paid the creditor funds entrusted to it, [citation omitted], the burden then shifts to the debtor-fiduciary to show that it complied with its fiduciary duties. [Citations omitted.][4]

The first question the Court must answer, then, is whether the state court's restraining order required Womack to hold contested fees "in a fiduciary capacity." The Court is convinced that it did. The order identified the client matters that it covered, and directed Womack to keep fees he had received or would receive in connection with those matters in his trust account pending further order of the court. Even if the order might be viewed as insufficient to impose a fiduciary capacity on an ordinary litigant, Womack is also an attorney and an officer of any court before which he appears. In that capacity, he had a professional obligation to obey the state court's order.[5]

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[2]91 F.3d at 1371-1372 (citations and internal quotation marks omitted).

[3]216 B.R. 283 (10th Cir. BAP 1997).

[4]216 B.R. at 288.

[5]*See, e.g.*, *In re Anderson*, 247 Kan. 208, 211-12 (1990), *cert. denied* 498 U.S. 1095 (1991) (attorney engaged in conduct prejudicial to administration of justice, in violation of Kansas Model Rule of Profession Conduct 8.4(d), by refusing to obey child custody and support orders); *In re*

Because Womack failed to comply with his court-imposed obligation to hold the covered fees in his trust account, under *Storie*, the burden shifts to him to show that he complied with his fiduciary duties. Before the state court, Womack argued that he was free to dispose of the money because Ingram had rejected a tender of the money. In the legal brief he submitted when this Court directed the parties to supply copies of the restraining order and the settlement agreement, Womack has offered three additional justifications for his failure to retain the money in his trust account as required by the restraining order: (1) he believed that his primary pre-existing legal duty was to the bankruptcy trustee, and all money "that could be identified to Mr. Womack alone" should be used to preserve the assets of the bankruptcy estate; (2) he believed that any motion filed "in this regard" (apparently meaning any motion seeking the state court's permission to remove money from his trust account) would constitute an acceptance of the state court's jurisdiction over the money, jurisdiction which he denied existed; and (3) filing a motion would have been a useless act because he always had the right to convert his bankruptcy case to Chapter 7, and even if he had followed the state court's order, Ingram would not have collected the money because on conversion to Chapter 7, all collection efforts would have had to cease.

The Court cannot accept any of Womack's assertions. Any hopes Womack might have of this Court redetermining whether Ingram's alleged rejection of Womack's claimed tender of money excused Womack from complying with the restraining order are misdirected. The state court already resolved this question against Womack, and determined that he committed civil contempt by removing

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Black, 247 Kan. 664, 664-65 & 667-68 (1990) (attorney violated MRPC 8.4(d) by, among other things, ignoring court rules and orders).

the disputed fees from his trust account. A federal statute, 28 U.S.C.A. §1738, requires this Court to give that decision the "same full faith and credit" that the state courts of Kansas would. If, despite the pending appeal, other Kansas state courts would hold that the trial court's decision on that question barred Womack from asserting in separate litigation his claim that he had a valid excuse for violating the order, then this Court must follow that rule as well. A leading treatise on federal practice and procedure declares that, when an appeal of a decision is pending: "The Supreme Court long ago seemed to establish the rule that a final judgment retains all of its res judicata consequences pending decision of the appeal, apart from the virtually nonexistent situation in which the 'appeal' actually involves a full trial de novo. The lower courts have taken the rule as settled ever since."[6] The Tenth Circuit has stated that Kansas follows this rule.[7] Consequently, so long as the judgment against Womack remains in effect pending appeal, this Court may not consider Womack's argument that Ingram's rejection of a tender of money excused Womack from complying with the restraining order. In fact, the judgment also precludes this Court from questioning on any other basis whether Womack violated the state court's restraining order.

But Womack's three new arguments are not convincing anyway. First, the Court notes that Womack does not dispute that he either already had or later received money that was subject to the state court's restraining order, unless somehow his pending bankruptcy case prevented the money from being subject to the order. But a party, especially one who is an attorney, with legal proceedings

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[6] 18A Wright, Miller & Cooper, *Federal Prac. & Pro.: Jurisdiction and Related Matters 2d* §4433 at 78-79 (2002).

[7] *Phelps v. Hamilton*, 122 F.3d 1309, 1318 (10th Cir. 1997) (citing *Willard v. Ostrander*, 51 Kan. 481, 486-90 (1893); *Munn v. Gordon*, 87 Kan. 519, 521-22 (1912)).

pending before two courts must realize that he cannot decide for himself the proper resolution of possible conflicts between the two courts' jurisdiction. If Womack thought the restraining order improperly interfered with this Court's jurisdiction, he should have sought relief on this ground from one of the two courts. An order from this Court might have protected him from the force of the state court's restraining order, but his own decision to resolve any jurisdictional conflict could not. This claim also ignores the fact that, from the perspective of Womack's bankruptcy case, the purpose of the state court proceeding was to determine whether Ingram and Womack had been in a law partnership and, if so, what fees and other property belonged to that partnership and should ultimately be distributed to Womack as his share of the partnership assets. Only the fees and other property determined by the state court to belong to Womack would become property of his bankruptcy estate. To the extent that Womack believed the state court erroneously found that money belonged to the partnership, and not to him personally, his remedy was to appeal that decision, not simply to act on his own belief. The Court further notes that the credibility of Womack's claim that he was acting under a duty to preserve for the bankruptcy estate money that was subject to the restraining order is seriously undermined by his admission that several hundred thousand dollars were administered in the state court case and distributed under that court's jurisdiction. These considerations convince the Court that Womack's first two assertions are incorrect.

Womack's third assertion is nonsensical. Even if converting his case to Chapter 7 would somehow have made the stay relief Ingram had obtained no longer effective, the state court's determination that the $40,224.84 belonged to Ingram would have required Womack to distribute that money to Ingram if Womack had still had it in his trust account. Ingram would have had no need to

resort to any other collection activities. Furthermore, since the money the state court determined was partnership property that should be distributed to Ingram would not be property of Womack's bankruptcy estate, the automatic stay would not have protected that property from Ingram's collection efforts.

Because the restraining order required Womack to hold the disputed fees in his trust account pending further order of the state court, his removal of some of that money without the court's approval, and without a valid excuse, constituted a "defalcation while acting in a fiduciary capacity." Unless Womack succeeds in getting the state court's determination that he committed civil contempt by disposing of the money reversed on appeal, his obligations to pay Womack the $40,224.84 plus attorney fees and expenses of $12,123.10 will be nondischargeable under §523(a)(4). Womack makes other assertions in the brief he submitted to the Court, and he may intend one or more of them to state other reasons why his failure to abide by the restraining order was justified and should be excused. These explanations are inadequate for one or more of the same reasons as the explanations specifically addressed above.

The Court will now address Ingram and Brown's other asserted ground of nondischargeability. As indicated, §523(a)(6) excepts from discharge a debt "for willful and malicious injury by the debtor to another entity or to the property of another entity." While Womack's intent in violating the state court's restraining order was not relevant in determining whether his obligations to Ingram were covered by §523(a)(4), the Supreme Court has ruled that §523(a)(6) applies only to a deliberate or

intentional injury, not merely a deliberate or intentional act that leads to injury.[8] Questions about a person's intent or other state of mind require consideration of intangible factors such as witness credibility and can rarely be resolved by summary judgment.[9] Certainly, the circumstances presented here could support a conclusion that Womack disposed of more than $40,000 from his trust account in order to harm Ingram by keeping him from getting the money. However, a factfinder could also accept one or more of Womack's assertions about why he thought he was free to disregard the state court's restraining order as establishing that he had no intent to injure Ingram by spending the money. Consequently, the Court would have to hear Womack's testimony and any other potentially relevant evidence before it could determine his state of mind when he violated the restraining order. The Court need not hear evidence now, though, since the present circumstances are sufficient to establish nondischargeability under §523(a)(4).

In case the parties and the Kansas appellate courts might have any doubts, the Court hereby grants relief from the automatic stay so that Womack's appeal of the state court's order, and any subsequent proceedings that may be necessary, may proceed to completion. Womack's obligations to Ingram (and to Brown, if any) will be nondischargeable unless the state trial court's decision is altered in some material way as a result of Womack's appeal.

IT IS SO ORDERED.

Dated at Topeka, Kansas, this _____ day of April, 2003.

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[8]*Kawaauhau v. Geiger*, 523 U.S. 57, 61-64 (1998).

[9]*Prochaska v. Marcoux*, 632 F.2d 848, 851 (10th Cir. 1980), *cert. denied* 451 U.S. 984 (1981); see also 10B Wright, Miller & Kane, *Federal Practice & Procedure: Civil 3d*, §2730 at 4-7 (1998) (indicating actions involving state of mind can rarely be determined by summary judgment).

JAMES A. PUSATERI
BANKRUPTCY JUDGE